Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-178

ARCHIBALD MAULDING and
HARRY D. RIMBEY, *Petitioners*

v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

OPINION BELOW

The opinion of the court of appeals (Pet. App. A, *infra*, pp. 1a to 6a) consists of an unpublished order. The relevant portions of the district court's jury instructions are reprinted at Pet. App. B, *infra*, pp. 7a to 8a.

JURISDICTION

The judgment of the court of appeals was entered on April 10, 1978 (Pet. App. C, *infra*, p. 9a). On May 19, 1978, the court of appeals denied a timely petition for rehearing with a suggestion for rehearing *en banc* (Pet. App. D, *infra*, pp. 10a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under Section 6672 of the Internal Revenue Code of 1954, the term "willfully" includes carelessness or recklessness so that a corporate officer may be held liable for the 100 percent penalty, although he did not know of his company's failure to pay over withholding taxes, if he failed to investigate circumstances that would have revealed such nonpayment.

STATUTE INVOLVED

Section 6672 of the Internal Revenue Code of 1954, 26 U.S.C § 6672, provides:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

STATEMENT

In 1968 and 1969 petitioners were officers in Pine & Company, a corporation in Springfield, Illinois, engaged in the business of landscaping along roads and highways (Pet. App. A, *infra,* pp. 1a-2a).[1] During this period Pine & Company withheld F.I.C.A. (Social Security) and federal income taxes from the weekly wages paid to its employees but failed to pay over to

[1] "A" refers to the Appendix filed in the court of appeals. "Pet. App." refers to the Appendix to this Petition.

the United States the entire amounts withheld as required by 26 U.S.C. §§ 3102, 3402, 7501 (A23). For the last three quarters of 1968 and the first quarter of 1969, the Employer's Quarterly Tax Returns (Form 941) filed by the company showed a total of $85,591.19 in withheld taxes due to the federal government (*ibid.*). Although the company was required to make payments of withheld taxes each month to the United States, it made only two such monthly payments from April 1, 1968 to March 31, 1969 (*ibid.*).[2]

In February 1973, the Internal Revenue Service made assessments under Section 6672 of the Internal Revenue Code of 1954 (26 U.S.C. § 6672) for the amount due from Pine & Company against each of the petitioners and MacDonald Pine, the president of the company and its majority shareholder (A24). Section 6672 imposes personal liability for unpaid taxes on a individual ("responsible person") who is required to collect, account for and pay over taxes withheld from employees' wages but who "willfully" fails to do so.

Pine and each petitioner paid over to the United States an amount equal to the Social Security and income taxes withheld from one of the company's employees for each of the four quarters at issue (Pet. App. A, *infra,* p. 3a).[3] After the Internal Revenue Service refused their requests for refunds, petitioners and Pine filed actions in the United States District Court for the Southern District of Illinois seeking to

[2] See Treas. Reg. §§ 31.6011(a)-5, 31.6151(a), 26 C.F.R. §§ 31.6011(a)-5, 31.6151(a).

[3] The unpaid taxes are considered divisible and a taxpayer who pays over a portion of the assessment may therefore bring a refund suit. See, *e.g., Steele* v. *United States,* 280 F.2d 89 (8th Cir. 1960).

recover the amounts they had paid over and the United States filed counterclaims for the balance due on the assessments (*ibid.*). The three cases were then consolidated and tried to a jury.

A.

DISTRICT COURT PROCEEDINGS

The evidence at trial showed that in 1968 and 1969 Pine owned 120 shares of Pine & Company stock and served as president of the company, a position he had held since its incorporation in 1957 (Pet. App. A, *infra,* p. 2a; A24). Petitioner Rimbey, the company's vice-president, held 57 shares and petitioner Maulding, who served as secretary-treasurer, owned 58 shares (*ibid.*).[4] Both petitioners received a salary of $1800 per year from the company (A59; A124). Pine, Rimbey and Maulding comprised the entire membership of the company's Board of Directors, which met once a year (A24; A57).

Petitioners did not, however, maintain offices at Pine & Company and during 1968 and 1969 spent little time in the building the company occupied (A66-67, A125-126). Instead Maulding and Rimbey devoted their attention to Calhoun County Construction Company, a general contractor that leased an office building to Pine & Company on its ten-acre tract (Pet. App. A, *infra,* p. 2a, A28-A34). As president of Calhoun, petitioner Rimbey received a salary of $30,000 per year and worked full time there (A119). Two or three of his working days per week were spent in the area of Alton,

[4] In addition to the company's 235 shares of common stock there were five shares of treasury stock (A226). There was no evidence that this treasury stock was voted (see A226; but see Pet. App. A, *infra,* p. 2a n.1).

Illinois (A126). Petitioner Maulding, as secretary of Calhoun, received a salary of $18,000 per year for his work in supervising six men and directing the repair and maintenance of more than 200 pieces of equipment (A34, A59).

Pine & Company maintained three checking accounts: a general account, a payroll account and a field account (Pet. App. A, *infra,* p. 2a; A27). Although each of the officers had authority to sign checks on these accounts, Pine regularly performed this function (Pet. App. *infra,* p. 2a; A59; A125). Petitioners occasionally signed checks when Pine was unavailable and, in such instances, the checks would be prepared by Delbert Donaldson, the company's office manager, who would take the checks to one of the petitioners for his signature (A59; A125).[5] Because Pine was unavailable, petitioner Maulding signed the company's Quarterly Tax Return for the second quarter of 1968 (A60-A61);[6] Donaldson signed the return for the third quarter of 1968 and Pine signed the returns for the fourth quarter of 1968 and the first quarter of 1969.[7]

[5] Donaldson himself had authority to sign checks from the payroll account but not from the general account, which was used to pay federal taxes, to replenish the payroll account, to pay creditors, and for other purposes (Pet. App. A, *infra,* p. 2a n.2; A27).

[6] Although this return showed a balance due to the government of more than $30,000, petitioner Maulding assumed that this money would be sent in with the return (A84-A85), as was Donaldson's usual practice (A358). In fact, a check for the amount due this quarter was sent in, but it was returned for lack of a signature (A358-A359); Donaldson admitted that he never presented the check to either petitioner for their signature (A366-A367).

[7] The stipulation entered into by the parties states that Donaldson signed the return for the fourth quarter of 1968 (A27). This is in error, however, since the actual return, introduced into evidence as plaintiff's Exhibit 10-C, contains Pine's signature (A469).

During the summer of 1968, Pine & Company began experiencing financial difficulties as its accounts receivable mounted (A233-A234). Office manager Donaldson received a number of overdraft notices from the Springfield National Bank, where the company had its checking accounts (A372), but Donaldson failed to inform either petitioner of this (A105, A372). In addition, the company was unable to make payments on loans it had received from the Springfield National Bank (A295f-A295j).

In February 1969, petitioners Maulding and Rimbey were first informed of the company's failure to pay over withholding taxes (A67, A127). Shortly thereafter the bank, which had a security interest in the company's equipment and accounts receivable, started a liquidating procedure to collect the balance due on the loans (A295s, A295x).

At the close of plaintiff's case, the district court granted a directed verdict in favor of the government, holding that petitioners and Pine were "responsible persons" within the meaning of Section 6672 (A4). The only issue thus left for the jury was the question whether petitioners and Pine had "willfully failed to pay over the withheld taxes.

In its closing argument, the government stressed its theory of the case that during the period of nonpayment of withholding taxes, petitioners, while they may have had no knowledge that the taxes were unpaid, nevertheless acted "willfully" under Section 6672 because they "close[d] their eyes to evidence that was so clear that it imposed on them a duty to investigate further to determine whether the tax had been paid" (A383, A388-389). The district court, over petitioners'

objections (A415), instructed the jury to the same effect (Pet. App. B, *infra,* at p. 8a):

> Mere negligence or simple carelessness due to preoccupation does not make conduct willful or amount to knowledge. However, a responsible person may not escape knowledge by closing his eyes to circumstances which should prompt him to investigate.
>
> "Willfulness" also includes a reckless disregard for obvious or known risks and failure to investigate or correct mismanagement after having actual notice of circumstances which, if investigated, would have disclosed that the withholding taxes had not been paid to the Government.
>
> Therefore, if you find that there existed, during the period the taxes in question were accruing, knowledge of an obvious risk by any of the plaintiffs that such taxes would not be paid, or that any of the plaintiffs were aware of such risk and thereafter failed to investigate the risk of non-payment, you may find that such plaintiff or plaintiffs acted willfully.

In answer to special interrogatories, the jury found that petitioners (and Pine) had acted willfully and the court entered a judgment holding petitioners and Pine jointly and severally liable in the amount of $81,466.95 (A1).

B.

THE DECISION OF THE COURT OF APPEALS

The court of appeals affirmed in an opinion designated as an unpublished order (Pet. App. A, *infra*).[8]

---

[8] See Rule 35, Rules of the United States Court of Appeals for the Seventh Circuit, as amended February 1, 1978.

The court held "that willfulness [within the meaning of Section 6672] requires either an intentional failure to pay over the withholding taxes or conduct evincing a wreckless [sic] disregard as to whether the amounts due to the government were paid or not (Pet. App. A, *infra,* at p. 5a)." This definition of willfulness, the court stated, was consistent with that established in *Kalb* v. *United States,* 505 F.2d 506 (2d Cir. 1975), *cert. denied,* 421 U.S. 979 (1975); *Teel* v. *United States,* 529 F.2d 903 (9th Cir. 1976); *and Monday* v. *United States,* 421 F.2d 1210 (7th Cir. 1970), *cert. denied,* 400 U.S. 821 (1970).

REASONS FOR GRANTING THE WRIT

In *Kalb* v. *United States,* 505 F.2d 506, 511 (2d Cir. 1975), *cert. denied,* 421 U.S. 979 (1975), the Second Circuit squarely rejected the government's argument that "[a] corporate officer acts 'willfully' within the meaning of section 6672 . . . when he should have known that taxes owed were not paid." In this case, however, the Seventh Circuit has joined the Ninth Circuit [9] in reaching a contrary conclusion. The term "willfully" in Section 6672 means, according to the court below, not only intentional and knowing failure to pay over withholding taxes but also failure to investigate circumstances that would have revealed the nonpayment of such taxes (Pet. App. A, *infra,* p. 5a; Pet. App. B, *infra,* p. 8a).

As we discuss below, the court of appeals' decision here conflicts with *Kalb,* is inconsistent with the decisions of other courts of appeals and contradicts the position of the United States before this Court in

[9] See *Teel* v. *United States,* 529 F.2d 903, 905 (9th Cir. 1976).

United States v. *Sotelo,* —— U.S. ——, No. 76-1800, decided May 22, 1978, regarding the meaning of "willfully" in Section 6672. Moreover, in *Bishop* v. *United States,* 412 U.S. 346 (1973), this Court held that "willfully" does not include reckless conduct for purposes of the criminal tax statutes and there is no basis for a different interpretation of the term as used in Section 6672.

The proper definition of "willfully" in Section 6672 is an important and recurring issue. The 100 percent penalty provision of Section 6672 has generated numerous decisions in the lower federal courts and, as the government has informed this Court,[10] in fiscal 1976 alone there were $2 billion in withholding tax delinquencies, resulting in $61 million of assesments under Section 6672.[11]

The issue presented by this case has taken on added importance as a result of this Court's recent decision in *United States* v. *Sotelo, supra,* which holds that the Section 6672 penalty is not dischargeable in bankruptcy and becomes, as Mr. Justice Rehnquist stated in his dissenting opinion, a "life-long liability." [12] If the

[10] See Petition for a Writ of Certiorari, at p. 6, in *United States* v. *Sotelo,* No. 76-1800, *supra.*

[11] Within the Seventh Circuit, the Internal Revenue Service has reported that its Chicago district office, in fiscal 1976, had 28,559 businesses that were delinquent in paying $88.9 million in withholding taxes, that the Section 6672 penalty was imposed through assessments in 762 cases and that the total penalty assessments were $8.9 million. See U.S. Comptroller General Opinion B-137762, May 3, 1977, reprinted in 9 CCH 1977 Stand. Fed. Tax Rep. ¶ 6614, p. 71, 439.

[12] *United States* v. *Sotello, supra* (46 U.S. Law Week at p. 4477).

decision below [13] is allowed to stand, a corporate officer will incur this "heavy" civil penalty [14] and be subject to criminal sanctions [15] whenever he should have known, although he did not in fact know, that his company had failed to pay over the taxes withheld.

1. Such a definition of "willfully" for purposes of Section 6672 injects the element of negligence into a statute designed to penalize only conduct that is intentional and knowing. The government itself has recognized that Section 6672 may be invoked solely for deliberate conduct, not carelessness. Seeking to persuade this Court in *United States* v. *Sotelo, supra,* that a responsible officer should not be allowed to discharge his Section 6672 liability in bankruptcy, the government argued: "The statutory term 'willful' as used in the section refers only to a voluntary and conscious decision to prefer other creditors." [16]

This sets the government squarely at odds with the court of appeals here: one obviously cannot make a voluntary and conscious choice to prefer other creditors over the government unless he in fact knows that the government has not been paid. By contrast, under the ruling in this case a person is liable for a 100 percent penalty, despite his lack of knowledge of unpaid withholding taxes, because he should have taken steps to

[13] And the decision of the Ninth Circuit in *Teel* v. *United States, supra,* n.9.

[14] *Slodov* v. *United States,* No. 76-1835, decided May 22, 1978 (46 U.S. Law Week 4463, 4469).

[15] See 26 U.S.C. § 7202, which, as the Court pointed out in *Slodov* v. *United States, supra,* "tracks the wording of § 6672" (46 U.S. Law Week, at p. 4465).

[16] Brief for the United States, at p. 28 n. 19.

find this out or, as the court of appeals put it, he acted in reckless disregard of whether the amounts due to the government had been paid (Pet. App. A, *infra,* at p. 5a).[17]

With the exceptions of the Seventh Circuit in this case and the Ninth Circuit in *Teel* v. *United States, supra,* the government's definition of "willfully" in its *Sotelo* brief accurately represents the views of the other courts of appeals that have interpreted Section 6672.[18] These courts have uniformly held that "willfully" under Section 6672 means that the responsible officer voluntarily, consciously and intentionally preferred the other creditors over the United States.[19] That

[17] As the district court instructed the jury (Pet. App. B, *infra,* at p. 8a):

> "Willfulness" also includes a reckless disregard for obvious or known risks and failure to investigate or correct mismanagement after having actual notice of circumstances which, if investigated, would have disclosed that the withholding taxes had not been paid to the Government.
>
> Therefore, if you find that there existed, during the period the taxes in question were accruing, knowledge of an obvious risk by any of the plaintiffs that such taxes would not be paid, or that any of the plaintiffs were aware of such risk and thereafter failed to investigate the risk of non-payment, you may find that such plaintiff or plaintiffs acted willfully.

[18] The position of the Court of Claims is unclear. *Compare* the trial judge's opinion, adopted by the court in *Bauer* v. *United States,* 543 F.2d 142, 150 (Ct. Cl. 1976) ("Mere negligence in failing to ascertain facts regarding a tax delinquency is insufficient to constitute willfulness under the code") *with* the trial judge's opinion, adopted by the court in *Bolding* v. *United States,* 565 F.2d 663, 674 (Ct. Cl. 1977).

[19] See, *e.g., Anderson* v. *United States,* 561 F.2d 162 (8th Cir. 1977); *Hartman* v. *United States,* 538 F.2d 1336, 1341 (8th Cir. 1976); *Harrington* v. *United States,* 504 F.2d 1306, 1311 (1st Cir. 1974); *Burden* v. *United States,* 486 F.2d 302, 304 (10th Cir. 1973), *cert. denied,* 416 U.S. 904 (1974); *Lidden* v. *United States,*

too had been the view of the Internal Revenue Service, which denfied willfully in Section 6672 "as meaning intentional, deliberate, voluntary, and knowing as opposed to accidental." [20]

The court's error here stems in part from its misreading of *Kalb* v. *United States, supra,* an opinion which in fact conflicts with the decision below, as we indicated earlier. After rejecting the government's contention that a corporate officer acts "willfully" under Section 6672 if "he should have known that taxes owed were not paid," the court in *Kalb* stated (505 F.2d at 511):

> *Monday* [*v. United States, supra*] defined willfull action under § 6672 as "voluntary, conscious and intentional—as opposed to accidental—decisions not to remit funds properly withheld to the Government." 421 F.2d at 1216. That definition has been widely accepted . . . . *Monday* also points out, as has to be the case, that willful conduct "may also indicate a reckless disregard for obvious or known risks." 421 F.2d at 1215. Willful conduct also includes failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government.

The court in *Kalb* thus did not say that reckless disregard or failure to investigate constitutes willfulness despite the responsible person's lack of knowledge of

448 F.2d 509, 513 (5th Cir. 1971); *Braden* v. *United States,* 442 F.2d 342, 344 (6th Cir.), *cert. denied,* 404 U.S. 912 (1971); *Spivak* v. *United States,* 370 F.2d 612, 615 (2d Cir.), *cert. denied,* 387 U.S. 908 (1967); *Cross* v. *United States,* 311 F.2d 90, 94 (4th Cir. 1962).

[20] U.S. Comptroller General Opinion B-137762, *supra,* 9 CCH 1977 Stand. Fed. Tax Rep. at p. 71, 438.

the unpaid taxes. The court had already disagreed with the government that a corporate officer could be considered to have acted willfully if he violated "a duty to know about the arrearage in withholding taxes." 505 F.2d at 511. The court in *Kalb* did state that willfulness may indicate reckless disregard of *known* risks. Properly understood, however, this statement is accurate. Whenever a responsible person deliberately uses withheld tax funds to pay other creditors while knowing the government has not been paid, he acts in reckless disregard of the risks that the government will not receive the sums due to it and that he will suffer the Section 6672 penalty. This is clearly explained in *Lidden* v. *United States,* 448 F.2d 509, 513 (5th Cir. 1971), which we quote in the margin.[21]

2. The court of appeals' erroneous definition of "willfully" [22] also has consequences in the criminal tax area "because Congress has created a law enforcement

[21] The court in *Lidden* v. *United States, supra,* explained (*id.*):

> [W]hen the responsible person knows that the withheld funds are being used for other corporate purposes (regardless of his expectation that sufficient funds will be on hand for payment over to the Government), and thus voluntarily and consciously risks the withheld taxes in the operation of the corporation, he does so at his peril and subjects himself to liability under section 6672 if the corporation is unable to remit the withheld taxes.

Monday v. *United States, supra,* which the court in *Kalb* quoted in its statement regarding reckless disregard, is to the same effect, as the jury instruction there approved indicates. See *Monday* v. *United States, supra,* 421 F.2d at 1216. That instruction does not mention recklessness and adheres to the standard definition that the responsible person must have acted voluntarily, consciously and intentionally. *Id.*

[22] And the Ninth Circuit's decision in *Teel* v. *United States, supra.*

system in which criminal and civil elements are inherently intertwined." *United States* v. *LaSalle National Bank*, —— U.S. —— (No. 77-365, decided June 19, 1978) (46 U.S. Law Week 4713, 4716). As this Court pointed out in *Slodov* v. *United States, supra*, (46 U.S. Law Week at p. 4465), the felony provision of Section 7202 [23] tracks the wording of the civil penalty provision in Section 6672 and also turns on whether the responsible officer acted "willfully" [24] in failing to pay over withholding taxes. Aside from requiring criminal intent for a felony conviction, there is no indication that Congress intended "willfully" in Section 7202 to mean something other than its meaning in Section 6672.[25] And the courts are unanimous in holding that the only difference between the two statutes is that under Section 6672 evil intent or bad motive need not be present.[26]

Yet this Court and the lower federal courts interpreting the criminal tax statutes, have rejected the view adopted by the court below that "willfully" includes recklessness or carelessness. In *Bishop* v. *United States*, 412 U.S. 346 (1973), the Court held that in tax

[23] 26 U.S.C. § 7202 provides:

> Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

[24] See also 26 U.S.C. § 7501(b).

[25] In other words, "willfully" as used in the civil statute means only deliberate conduct, while in the criminal statute it means deliberate conduct plus criminal intent.

[26] See, *e.g.*, *Hartman* v. *United States, supra*, 504 F.2d at 1311, and cases there cited.

felony and misdemeanor statutes (which include Section 7202) unreasonable, capricious or careless disregard cannot be equated with the deliberate and intentional conduct needed to establish willfulness.[27] As the court of appeals explained in *United States* v. *Bengimina*, 499 F.2d 117, 119-120 (8th Cir. 1974):

> *Willful cannot fairly be equated with careless or reckless.* The denotation of willful is deliberate and intentional. Its connotations are many, depending to a considerable extent on the context in which the word is used. *Careless or reckless are more accurately equated with a negligent or inadvertent disregard of the proprieties of any given situation.* [Emphasis added.][28]

If, as the courts have held, careless or reckless conduct cannot satisfy the element of willfulness in Section 7202, there is no basis for holding that such conduct constitutes willfulness under Section 6672. The relevant language in both statutes is identical and the court below offered no reason why they should be interpreted differently.

3. The fact that the court of appeals designated its opinion as an unpublished order under its Local Rule 35 (see note 8 *supra*) should not insulate the case from review by this Court. In recent years this Court has granted certiorari in cases that otherwise warranted review even when the court below disposed of the appeal with an unpublished opinion or order. See, *e.g.*, *Moore* v. *Illinois*, —— U.S. —— (No. 76-5344, decided December 21, 1977) (46 U.S. Law Week 4050); *United*

[27] See 412 U.S. at 359.

[28] 412 U.S. at 350, 354, 359, 361. See also *United States* v. *Pomponio*, 429 U.S. 10 (1976).

States v. *Santana*, 427 U.S. 38 (1976); *Giglio* v. *United States*, 405 U.S. 150 (1972).

Moreover, the decision here represents the law of the Seventh Circuit and all the judges of that court are aware of it. Attorneys for the federal government can be expected to seek, in the district courts of the Seventh Circuit (and elsewhere), jury instructions similar to those approved in this case. The importance of the issue presented is further emphasized by the fact that the Ninth Circuit, in *Teel* v. *United States, supra*,[30] has adopted the same definition of "willfully" in Section 6672 as did the court below in this case. The issue presented here is therefore not only significant but also one that can be expected to recur frequently.

[29] Other courts of appeals have held it to be plain error requiring reversal of a criminal tax conviction for a court to instruct the jury that willful conduct includes recklessness. See *Vitiello* v. *United States*, 363 F.2d 240 (3d Cir. 1966); *Haner* v. *United States*, 315 F.2d 792 (5th Cir. 1963).

[30] See also note 18, *supra*, with respect to the Court of Claims.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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July, 1978.

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

Unpublished Order Not to Be Cited Per Circuit Rule 35

(Argued October 31, 1977)

April 10, 1978.

Before

Hon. ROBERT A. SPRECHER, Circuit Judge

Hon. WILLIAM J. BAUER, Circuit Judge

Hon. WILLIAM J. CAMPBELL, Senior District Judge*

HARRY D. RIMBEY, ARCHIBALD MAULDING and MACDONALD PINE, Plaintiffs-Appellants,

vs.

UNITED STATES OF AMERICA, Defendant-Appellee.

Nos. 77-1550 and 77-1551

Appeal from the United States District Court for the Southern District of Illinois, Southern Division

S-Civ-73-126
S-Civ-73-127
S-Civ-74-80

Robert D. Morgan, *Judge*

Order

Pine and Company was incorporated in 1957 and was engaged in the business of landscaping along roads and

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* Senior District Judge William J. Campbell of the Northern District of Illinois is sitting by designation.

highways in Illinois. Plaintiff MacDonald Pine, who owned 120 of the company's 235 shares of common stock, was the president and a director of the company. Plaintiff Harry D. Rimbey owned 57 shares of stock and was the company's vice president and a director. Plaintiff Archibald Maulding, who served as secretary-treasurer, owned 58 shares.[1] The company rented office space from Calhoun County Construction Company. Both Rimbey and Maulding were shareholders and officers of that company in addition to their responsibilities with Pine and Company.

Pine and Company maintained three checking accounts consisting of a general account, a payroll account, and a field account. All three plaintiffs were authorized to sign checks on all three accounts. The general account was used to pay the company's creditors; it was also from this account that federal taxes were paid. It was stipulated that at various times each of the three plaintiffs signed checks in payments to creditors other than the defendant United States. It was further stipulated that each of the plaintiffs had authority to obtain loans on behalf of the company.

Pine and Company's employees were paid on a weekly basis, and income and Social Security taxes were withheld from their wages. Forms 941, employer's quarterly tax returns, were filed by the company for the last three quarters of 1968 and the first quarter of 1969. Plaintiff Maulding signed the return for the second quarter of 1968; plaintiff Pine signed the return for the first quarter of 1969; the returns for the third and fourth quarters of 1968 were signed by Delbert Donaldson, the company's general manager.[2] Each of the Forms 941 indicated that withholding taxes were due to the United States; the balances owing, however, were never paid.

[1] There were five treasury shares which Rimbey and Maulding voted, giving them equal voting power with Pine.

[2] With respect to the checking accounts of the company, Donaldson was only authorized to sign checks drawn on the payroll account.

Under Sections 3102(a) and 3402(a) of the Internal Revenue Code of 1954, an employer has the duty to collect withholding taxes by deducting the amount of the tax from the wages paid to employees. A 100 per cent penalty is assessable for failure to collect, account for, or pay over such a tax. 26 U.S.C. § 6672. The penalty is not limited to employers, but rather is made applicable to "any person" who is actually responsible for an employer's failure to withhold and pay over the tax.

This case involves a 100 per cent penalty assessment under 26 U.S.C. § 6672 in the amount of $81,466.95 against the plaintiffs as the responsible persons of Pine and Company for the last three quarters of 1968 and the first quarter of 1969. Each plaintiff paid an amount equal to the Social Security and income taxes withheld for one employee for each quarter and filed a claim for a refund which was disallowed. This action ensued, and the government counterclaimed for the unpaid balance of the penalty. At the conclusion of plaintiffs' case, the district court directed a verdict in favor of the government that each plaintiff was a responsible person within the meaning of 26 U.S.C. § 6672. Special interrogatories were submitted to the jury, which found plaintiffs' failure to pay willful. The issues raised by all three plaintiffs relate to those two determinations. We affirm.

All plaintiffs first contend that the district court erred in directing a verdict that they were responsible persons who were required to collect, truthfully account for, and pay over the withholding taxes. We note at the outset that 26 U.S.C. § 6771(b) defines "person" as an officer or employee of a corporation who is under a duty to perform the act in respect of which the violation occurs. Generally, liability for discharging the duties imposed by 26 U.S.C. §§ 3102(a) and 3402(a) attaches to those with power and

responsibility in the corporate structure for seeing that the taxes withheld are remitted to the government. *Monday* v. *United States*, 421 F.2d 1210, 1214 (7th Cir. 1970). More specifically, liability under § 6672 rests upon those persons who control the fiscal policy of the employer, *i.e.*, those who make the decisions as to allocation of funds among creditors. See: *Haffa* v. *United States*, 516 F.2d 931 (7th Cir. 1975); *Adams* v. *United States*, 504 F.2d 73 (7th Cir. 1974; see also: *Slodov* v. *United States*, 552 F.2d 159 (6th Cir. 1977); *Bauer* v. *United States*, 543 F.2d 142 (Ct. Cl. 1976); *White* v. *United States*, 372 F.2d 513 (Ct. Cl. 1967); *United States* v. *Hill*, 368 F.2d 617 (5th Cir. 1966); *Pacific National Insurance Company* v. *United States*, 422 F.2d 26 (9th Cir. 1970).

In directing the verdict that the plaintiffs were responsible persons within the meaning of § 6672, the district court noted that the three plaintiffs were the sole stockholders, sole directors, and the sole officers of Pine and Company. Judge Morgan further noted that each of the plaintiffs had authority to sign checks on the company's general account and that thereby each could determine which creditors would be paid, "if choices could be made in that regard."

Considering the evidence in the light most favorable to plaintiffs, and giving them the benefit of all inferences which the evidence fairly supports, *Continental Ore Co.* v. *Union Carbide & Carbon Corp.*, 370 U.S. 690, 696 (1962); *Hohmann* v. *Packard Instrument Company, Inc.*, 471 F.2d 815, 819 (7th Cir. 1973), we are unable to conclude that the district court erred in determining that plaintiffs offered no evidence upon which the jury could properly find that they were not responsible persons within the meaning of § 6672. The evidence demonstrated that all three plaintiffs were the sole shareholders, officers and directors of Pine and Company. Each had the power to and, in fact, did sign checks on behalf of Pine and Company. Further, each was

empowered to negotiate loans on behalf of the company. On the basis of this evidence as a matter of law that plaintiffs had fiscal control over Pine and Company and were, therefore, responsible persons within the meaning of § 6672.

In answer to an interrogatory, the jury found that the plaintiffs' failure to collect and pay over the withholding willful. All three plaintiffs attack the jury's determination in various ways, but principally through an attack on the district court's instructions. It is clear that the willfulness requirement of § 6672 is met where the responsible person's conduct with respect to his tax duties can be characterized as done with knowledge of non-payment or done with a reckless disregard of whether payments were being made. *Kalb* v. *United States*, 505 F.2d 506 (2nd Cir. 1974); *Teel* v. *United States*, 529 F.2d 903 (9th Cir. 1976). Our review of the evidence in this case convinces us that the jury properly found plaintiffs' conduct willful.

With respect to the instructions Pine, Rimbey and Maulding contend that the district court's advising the jury on three occasions that plaintiffs were responsible persons, together with instructions to the effect that negligence in this case amounts to willfulness, resulted in a directed verdict on the question of willfulness. We find no merit to this contention. Our review indicates that the district court properly instructed the jury that willfulness requires either an intentional failure to pay over the withholding taxes or conduct evincing a wreckless disregard as to whether the amounts due to the government were paid or not. As such, the instruction comports with the definition of willfulness established in *Kalb* v. *United States, supra, Teel* v. *United States, supra,* and *Monday* v. *United States, supra.*

Rimbey and Maulding also contend that the district court erred in refusing the admission of testimony and exhibits tending to demonstrate that these plaintiffs spent a substantial portion of their time with enterprises other than

Pine and Company. In our view, the excluded evidence would not serve to controvert the evidence establishing Rimbey and Maulding as responsible persons, and hence we cannot say that the district court erred in refusing its admission.

Rimbey and Maulding also contend that the district court erred in refusing the admission of evidence tending to demonstrate the date when the plaintiffs became aware of the failure to pay over the withholding tax to the government. Maulding testified that he first learned of the withholding taxes not being paid on February 14, 1969. The district court rejected on the grounds of hearsay the offer of a February 14, 1969, diary entry by Maulding indicating that Pine and Company's withholding taxes had not been paid. We find that the diary entry was cumulative to the testimony of Maulding and, hence, find no error in its rejection.

Accordingly, for the reasons stated herein, the judgment of the district court is affirmed.

AFFIRMED.

APPENDIX B

Excerpts from the district court's jury instructions (A401-A403):

The term "willfully" means only that the act of failing to pay over the taxes was voluntarily, consciously and intentionally done. If the responsible persons, consciously, voluntarily and intentionally used the trust funds which were withheld, or cause or permitted them to be used for purposes other than payment of the withheld taxes, they are deemed to have acted willfully.

It is not necessary for you to determine that the plaintiffs had an intent to defraud or to deprive the United States of the taxes, nor is it necessary that bad motive or wicked designs be shown on the part of the plaintiffs. The only thing that need be shown in order to find that any of the plaintiffs was willful is that he knew the taxes had not been paid and made the deliberate choice to pay other creditors or to permit other creditors to be paid instead of paying the Government the taxes due.

If a responsible person pays employees their net wages at a time when the corporation does not have sufficient funds to pay the taxes withheld, and when the funds become available, he knowingly uses them to pay other creditors, that person acts willfully. This means that if you find that any of the plaintiffs decided to use corporate funds to pay corporate suppliers, employees' net take-home salaries, the rent or any other creditor, including themselves, other than the Government, at a time when he knew withheld taxes were due and owing to the Government, then you should find that they acted willfully in failing to see that the withheld taxes were paid.

It is no excuse that because of financial difficulties of the company the responsible persons, in good faith, hoped to pay the taxes at a later time when it was hoped, or expected that the company's financial position would improve. It is no excuse that the responsible persons used funds to pay creditors other than the Government because

of demands placed upon them by one or more of such other creditors.

Mere negligence or simple carelessness due to preoccupation does not make conduct willful or amount to knowledge. However, a responsible person may not escape knowledge by closing his eyes to circumstances which should prompt him to investigate.

"Willfulness" also includes a reckless disregard for obvious or known risks and failure to investigate or correct mismanagement after having actual notice of circumstances which, if investigated, would have disclosed that the withholding taxes had not been paid to the Government.

Therefore, if you find that there existed, during the period the taxes in question were accruing, knowledge of an obvious risk by any of the plaintiffs that such taxes would not be paid, or that any of the plaintiffs were aware of such risk and thereafter failed to investigate the risk of non-payment, you may find that such plaintiff or plaintiffs acted willfully.

APPENDIX C

Unpublished Per Curiam Order

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

April 10, 1978

Before

Hon. ROBERT A. SPRECHER, Circuit Judge
Hon. WILLIAM J. BAUER, Circuit Judge
Hon. WILLIAM J. CAMPBELL, Senior District Judge*

HARRY D. RIMBEY, ARCKIBALD MAULDING and MACDONALD PINE, Plaintiffs-Appellants,

vs.

UNITED STATES OF AMERICA, Defendant-Appellee.

Nos. 77-1550 & 77-1551

Appeal from the United Staes District Court for the Southern District of Illinois, Springfield Division

Nos. S-Civ-73-126, S-Civ-73-127, S-Civ-74-80

Morgan, Judge.

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Illinois, Springfield Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the order of this Court entered this date.

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* Senior District Judge William J. Campbell of the Northern District of Illinois is sitting by designation.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

May 19, 1978.

Before

Hon. ROBERT A. SPRECHER, Circuit Judge
Hon. WILLIAM J. BAUER, Circuit Judge
Hon. WILLIAM J. CAMPBELL, Senior District Judge*

HARRY D. RIMBEY, ARCHIBALD MAULDING and
MACDONALD PINE, Plaintiffs-Appellants,

vs.

UNITED STATES OF AMERICA, Defendant-Appellee.

Nos. 77-1550, 77-1551

Appeal from the United States District Court for the Southern District of Illinois, Southern Division.

Nos. S-CIV-73-126, S-CIV-73-127, S-CIV-74-80

Robert D. Morgan, *Judge.*

On consideration of the petition for rehearing and suggestion for rehearing *in banc* filed in the above-entitled cause by plaintiffs-appellants Harry Rimbey and Archibald Maulding, no judge in active service has requested a vote thereon,** and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

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* Senior District Judge William J. Campbell of the Northern District of Illinois is sitting by designation.

** Circuit Judge Harlington Wood, Jr., did not participate in the *in banc* consideration of this matter.

Copy mailed to Rimbey and Maulding on 5/24/78.

Supreme Court, U. S.
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No. 78-178

In the Supreme Court of the United States

OCTOBER TERM, 1978

ARCHIBALD MAULDING and HARRY D. RIMBEY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-178

ARCHIBALD MAULDING and HARRY D. RIMBEY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners seek review of the decision below holding that they willfully failed to pay over taxes withheld from the wages of their corporation's employees within the meaning of Section 6672 of the Internal Revenue Code of 1954 so as to be personally liable for the taxes not paid over.

The pertinent facts may be summarized as follows: Petitioners, together with MacDonald Pine, were the sole shareholders, directors and officers of Pine and

Company, a corporation engaged in landscaping in Illinois. For the last three quarters of 1968 and the first quarter of 1969, Pine and Company withheld income and social security taxes from its employees, filed the quarterly returns required, but failed to pay most of the withheld taxes over to the United States, as required by law[1] (Pet. 2-3; Pet. App. A 2a-3a). See 26 U.S.C. 3102(a), 3402(a) and 3404. Pine and Company maintained three checking accounts: a general account was used to pay creditors, and was the account from which taxes were paid. Only petitioners and Pine were authorized to draw checks on the general account. It was stipulated that petitioners and Pine signed checks in payment of creditors other than the United States at various times throughout the quarters at issue. The evidence showed that both petitioners were aware of the poor financial condition of Pine and Company during the pertinent quarters (A. 87-88, 90, 105, 151, 235, 241)[2] and that they both were aware of the withholding requirements and knew that withheld taxes were required to be paid over to the government (Pet. 5; Pet. App. A 2a-5a).

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[1] After unsuccessfully attempting to collect the withheld taxes from Pine and Company, the Internal Revenue Service assessed the taxes at issue against petitioners and Pine under Section 6672. Thereafter, those parties instituted this refund suit in the United States District Court for the Southern District of Illinois. Although Pine was a party in the courts below, he has not joined in the petition for certiorari.

[2] "A." refers to the record appendix filed in the court of appeals.

At the close of petitioners' evidence, the district court directed a verdict that they were responsible persons with respect to Pine and Company within the meaning of Section 6672. The only question submitted to the jury was whether petitioners' failure to pay over the withheld taxes was "willful." The district court instructed the jury that mere negligence does not make conduct willful. However, it further stated that " '[w]illfulness' also includes a reckless disregard for obvious or known risks and failure to investigate or correct mismanagement after having actual notice of circumstances which, if investigated, would have disclosed that the withholding taxes had not been paid to the Government" (Pet. App. B 8a). In response to special interrogatories, the jury found that petitioners had acted willfully and the court held petitioners and Pine jointly and severally liable for $81,466.95 (Pet. App. A 5a). The court of appeals affirmed. It held "that willfulness [within the meaning of Section 6672] requires either an intentional failure to pay over the withholding taxes or conduct evincing a wreckless [*sic*] disregard as to whether the amounts due to the government were paid or not" (Pet. App. A 5a).

1. The decision below correctly held that petitioners were personally liable under Section 6672 for the unpaid withholding taxes of their corporation.

Petitioners' sole contention is that the trial court erred in instructing the jury that willfulness within the meaning of the statute includes a reckless disregard for obvious or known risks. But the courts of

appeals have uniformly held that willful conduct for purposes of Section 6672 "may also indicate a reckless disregard for obvious or known risks." *Monday* v. *United States*, 421 F.2d 1210, 1215 (7th Cir.), cert. denied, 400 U.S. 821 (1970). Accord: *Teel* v. *United States*, 529 F.2d 903, 905 (9th Cir. 1976); *Bolding* v. *United States*, 565 F.2d 663, 674 (Ct. Cl. 1977); *Burack* v. *United States*, 461 F.2d 1282, 1291-1293 (Ct. Cl. 1972).

Contrary to petitioners' assertion (Pet. 8), the decision below does not conflict with *Kalb* v. *United States*, 505 F.2d 506 (2d Cir. 1974), cert. denied, 421 U.S. 979 (1975). There, the court rejected the government's argument that a corporate officer acts "willfully" for purposes of Section 6672 when he should have known that taxes owed were not paid. In the Second Circuit's view, conduct amounting to no more than negligence is not willful under Section 6672. But as petitioners acknowledge (Pet. 13), the court in *Kalb* expressly approved the statement in *Monday* v. *United States*, *supra*, that willful conduct " 'may also indicate a reckless disregard for obvious or known risks' " (505 F.2d at 511). Hence, the jury instructions that were approved by the court of appeals are entirely consistent with the definition of willfulness adopted by the Second Circuit in *Kalb*.

Petitioners argue (Pet. 19) that the district court improperly introduced the element of negligence into the definition of willfulness of Section 6672. But the district court did not charge the jury that it could conclude that petitioners' conduct was

willful if it determined that petitioners should have known that the withholding taxes had not been paid over to the government. Indeed, the trial court specifically instructed the jury that "[m]ere negligence or simple carelessness due to preoccupation does not make conduct willful or amount to knowledge" under Section 6672 (Pet. App. 8a). However, the court further instructed that a responsible officer may not escape liability by purposely closing his eyes to facts which would have put him on notice as to the corporation's default, and that willfulness includes a reckless disregard for obvious or known risks. It is this type of conduct that the courts have described as the voluntary, conscious and intentional preference of other creditors over the United States. The court of appeals therefore correctly concluded (Pet. App. 5a) that "the instruction comports with the definition of willfulness established in *Kalb* v. *United States*, *supra*, *Teel* v. *United States*, *supra*, and *Monday* v. *United States*, *supra*." [3]

---

[3] Petitioners further rely (Pet. 13-15) upon the definition of willfulness for purposes of the criminal tax provisions of 26 U.S.C. 7201-7215. But it is well settled that the personal liability imposed by Section 6672 is civil in nature. *Monday* v. *United States*, *supra*, *Botta* v. *Scanlon*, 314 F.2d 392, 393 (2d Cir. 1963). Unlike the criminal tax statutes which are designed to punish certain proscribed conduct, personal liability under Section 6672 is imposed as a collection device. Hence, it is not necessary that specific intent to defraud be proven in order to establish willfulness under Section 6672. *Monday* v. *United States*, *supra*; *Bloom* v. *United States*, 272 F.2d 215, 223 (9th Cir. 1959), cert. denied, 363 U.S. 803 (1960). The criminal tax decisions such as *Bishop* v. *United States*, 412 U.S. 346 (1973) are therefore not controlling precedents.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

NOVEMBER 1978

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ARCHIBALD MAULDING AND HARRY D. RIMBEY,
Petitioners,

v.

UNITED STATES OF AMERICA, *Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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PETITIONERS' REPLY MEMORANDUM

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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PETITIONERS' REPLY MEMORANDUM

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1. The government evidently agrees that it would be error for a court to instruct that a corporate officer acts "willfully" within the meaning of Section 6672 when he should have known, but did not know, that withholding taxes had not been paid.[1] But that is the standard embodied in the jury instruction the government now supports in this Court. The district court

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[1] See Memorandum for the United States in Opposition, at p. 4, discussing *Kalb* v. *United States*, 505 F.2d 506 (2d Cir. 1974), *cert. denied*, 421 U.S. 979 (1975).

below charged that petitioners acted "willfully" if they failed to investigate facts that "would have disclosed" the unpaid taxes.[2] This is a "should have known" standard and the jury must have understood it as such. No amount of tergiversation can transform the instruction upheld here into a proper definition of "willfully," which the government told this Court last Term "refers [in Section 6672] *only* to a voluntary and conscious decision to prefer other creditors."[3]

2. The government says that *Bishop* v. *United States*, 412 U.S. 346 (1973), was a criminal case and therefore is not controlling.[4] But this is quite unresponsive to the argument in our Petition (pp. 13-15) that if, as *Bishop* holds, careless or reckless conduct does not equal willful conduct under the felony counterpart of Section 6672 (18 U.S.C. § 7202), there is no basis for a different interpretation of the identical language in Section 6672. On that score the government is silent. It offers no reasons why Congress would have used the same words to convey different meanings and, we submit, there are none.

[2] The instruction is set forth at p. 7 of our Petition. It contrasts sharply with the statement in *Kalb* v. *United States*, *supra*, 505 F.2d at 511, that "Willful conduct also includes failure to investigate or to correct mismanagement *after having notice that withholding taxes have not been remitted to the government*" (emphasis added).

[3] Brief for the United States in *United States* v. *Sotelo*, 436 U.S. 268 (1978), at p. 28 n. 19 (emphasis added).

[4] Memorandum for the United States in Opposition, at p. 5 n. 3.

3. Section 6672 is, as we discussed in our Petition (pp. 9-10), one of the most frequently litigated provisions of the Internal Revenue Code and the proper interpretation of "willfully" as used in that statute is a recurring and important issue. This case presents the issue as clearly and crisply as any case that can be imagined.[5] It is an issue that should be settled by this Court, not only because of the conflicting decisions of the lower courts,[6] but also because the lingering uncertainty over the meaning of "willfully" in Section 6672 promises to breed much unnecessary litigation as the government attempts to press its erroneous interpretation in the district courts and the court of appeals.

[5] The only issue presented to the jury was whether petitioners acted "willfully" (see our Petition, at p. 6) and the facts of the case are clear. (However, we should point out that although the government states in its Memorandum in Opposition, at p. 2, that petitioners were aware of the poor financial condition of Pine and Company during the last three quarters of 1968, the record reflects only that in late 1968 petitioner Rimbey became aware that the company had financial difficulties because of mounting receivables (A151).)

[6] See our Petition, at pp.11-12. The government has chosen not to address our arguments why the decision below conflicts with the decisions of other courts of appeals and why the opinion in *Kalb* v. *United States*, *supra*, properly understood, does not support the notion that carelessness or even recklessness can establish the deliberate and intentional conduct comprehended by willfulness.

For the foregoing reasons and the reasons stated in our Petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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NOVEMBER 1978.